STATEMENT OF KEITH COLLINS
ECONOMIC ADVISOR TO
NATIONAL CROP INSURANCE SERVICES AND
FORMER USDA CHIEF ECONOMIST
BEFORE THE
UNITED STATES HOUSE COMMITTEE ON AGRICULTURE
SUBCOMMITTEE ON GENERAL FARM COMMODITIES
AND RISK MANAGEMENT

MAY 16, 2012

Chairman Conaway, Ranking Member Boswell, and Members of the Subcommittee, thank you for the invitation to appear at today's hearing to discuss farm programs and crop insurance as you continue the development of the 2012 Farm Bill.

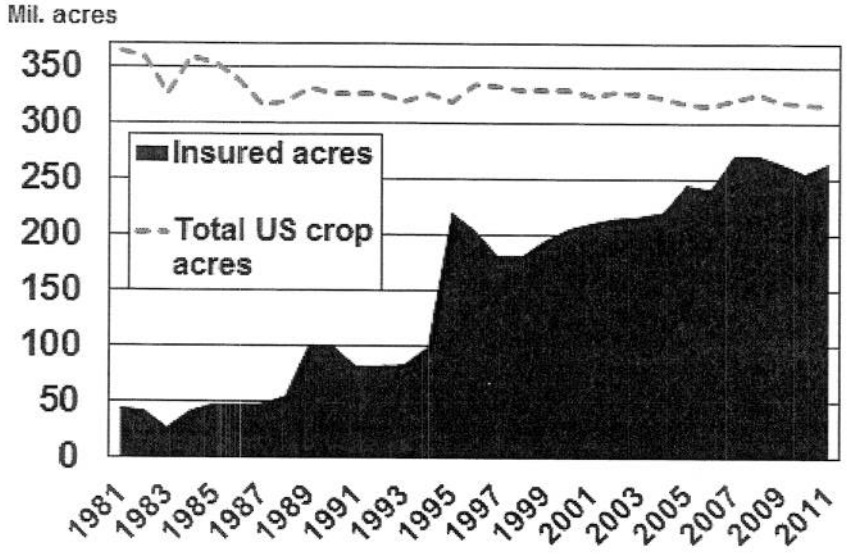
I served as USDA's Chief Economist from 1993 to the start of 2008. In that capacity I chaired the Board of Directors of the Federal Crop Insurance Corporation for seven years. Today, I serve as an economic and policy advisor to National Crop Insurance Services. NCIS is a non-profit organization representing all 15 companies that sell crop insurance. Its activities involve collection and management of information, analysis and reporting of data, research, and education. My comments reflect my views as an economist with some experience in market behavior, farm programs, and crop insurance.

Today, I will discuss the current state of crop insurance and its key features, discuss the adequacy of crop insurance to serve as the central part of the farm safety net, and provide my view of the challenges the Subcommittee faces in designing effective farm financial safeguards as part of the 2012 Farm Bill.

The Growth of Crop Insurance and the Features Driving Growth

The use of crop insurance by U.S. farmers has grown sharply, increasing from 45 million insured acres in 1981 to over 265 million in 2011 (Figure 1). Insured liability has increased even faster, rising from $6 billion in 1981 to more than $114 billion in 2011. More insured acreage, higher crop prices, and farmers buying higher coverage levels explain the sharp rise in liability. Several factors explain the strong growth in the use of crop insurance by farmers over time. Private sector delivery, which began with the Federal Crop Insurance Act of 1980, has provided strong incentives to sell and effectively service policies. Private sector compensation, subject to a cap, is tied to the value of premium sold, incentivizing companies and agents to bring crop insurance to producers. Increases in premium subsidies and government payment of insurance company delivery costs made crop insurance increasingly affordable over time, boosting participation and coverage levels.

Fig. 1. Acres Enrolled in Crop Insurance



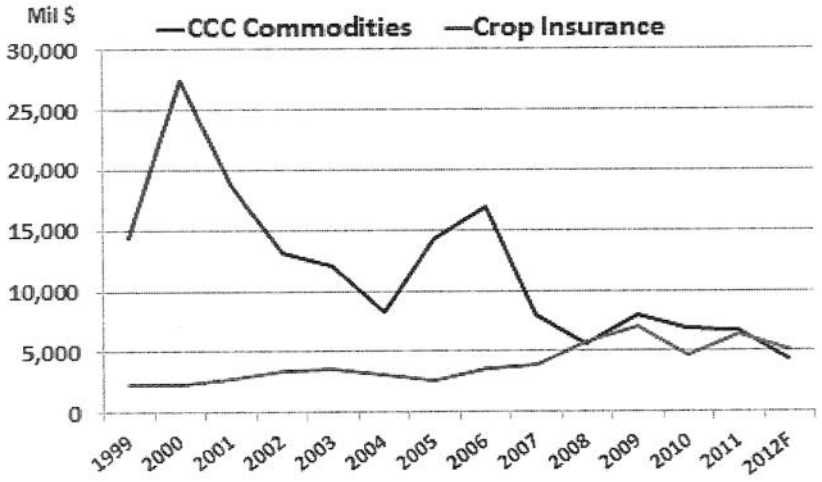
Sources: USDA/RMA Summary of Business; USDA/NASS Acreage.

Other factors also contributed to higher demand for crop insurance. The Federal Crop Insurance Reform Act of 1994 required producers to have crop insurance to be eligible for farm program benefits. While short lived, this requirement introduced many producers to crop insurance. Reductions in the level of protection provided by farm programs and requirements to have crop insurance in order to be eligible for the receipt of *ad hoc* disaster payments encouraged participation and higher coverage levels. An environment of higher and more volatile commodity prices has meant farmers have more to lose, a likely factor spurring coverage. Education efforts to acquaint producers with risk management strategies may have also increased demand. Program improvements have also attracted producer participation. These improvements, introduced especially during the late 1990's and later, included more appropriate premium rates for some crops; reduction of waste, fraud, and abuse; and new and better plans of insurance, such as revenue plans. Today, crop insurance is a risk-based program that does not make annual subsidy payments to farmers. When crop insurance does provide monetary benefits to farmers, the benefits are made available in the form of an indemnity payment that restores only a portion of an actual annual loss. Many farmers pay crop insurance premium costs for a number of years without receiving indemnity payments because they have not experienced an actual loss.

Meanwhile, farm programs have evolved from very market intervening programs that focused on offsetting low prices by using price supports, acreage controls, and price-based deficiency payments to programs that let market forces operate more fully, with producers shouldering greater responsibility to manage risks. This evolution has been facilitated by rising commodity prices. It has led to increased use of revenue concepts in government-delivered farm programs, such as the Average Crop Revenue Election (ACRE) and the Supplemental Revenue Assistance Payments (SURE) programs in the 2008 Farm Bill. While this evolution in farm programs reflects efforts to reduce the consequences of government intervention in markets and to reduce farm program spending, the shift also has been partly a consequence of policy decisions to improve and rely more on crop insurance as well as the demonstration by the crop

insurance program that it could meet such a responsibility by delivering products that farmers value. This transition in programs is illustrated in Figure 2, which shows the trend in lower farm program spending and greater crop insurance spending. *An important observation is that the sum of farm program and crop insurance program spending has been trending down. While crop insurance outlays have grown and substituted for farm program spending, the net taxpayer obligation for the farm safety net has been declining.*

Fig. 2. Outlays on Crop Insurance and CCC Commodity Programs, *fiscal years*



Sources: CCC from 2012 President's Budget. Crop insurance, 1999-2009 from USDA/RMA; 2010-12 from CBO 2012 March Baseline.

The expanding role of crop insurance in the farm safety net signals several key features that farmers and policymakers find attractive. These include: the requirement that a producer has to consciously elect to manage risks, insurance plans that can be designed to fit individual farm risks, producers share in the program costs, and accountability that comes with cost sharing. In addition, the private sector delivers the program as part of a public/private partnership that involves risk sharing between the government and the private companies. This arrangement means competition among private companies to deliver the program, producer choice among companies and agents, greater accountability by companies to ensure program integrity, lower reinsurance losses by the government, and efficiency and quality in delivery service. Private delivery and the structure of the program also enable producer losses to be adjusted accurately and indemnities paid promptly. In addition, USDA has wide latitude to establish program provisions, including new product development, premium rate setting, and compliance. This flexibility enables the program to adjust to producer needs and address program parameters to reduce costs and inefficiencies without the need for Congressional action. Crop insurance also allows many producers to secure credit, as an insurance policy serves as collateral, and aids forward marketing by providing resources to meet delivery obligations in the event of a production loss. This access to credit may be particularly important for new and beginning farmers. *Insurance is the fundamental method for managing risk across personal and business activities. Given the above attributes, there are many compelling reasons to conclude that*

insurance should be the fundamental way to manage production, price, and income risk for farmers in the future.

Crop Insurance as the Central Part of the Future Farm Safety Net

If crop insurance is to be the central part of the farm safety net, then a reasonable question is: does crop insurance serve all risks, all crops, and all regions well in a cost-effective way? With regard to risk, it is clear that farmers today face many risks that are addressed by farm programs and crop insurance only partly or not at all. The shocks that may disrupt a farm operation may come from many sources: the macroeconomy, natural disasters, person-made disasters, input availability and quality, trade policy, energy policy, climate policy, food policy, technology policy, and environmental policy. These shocks can affect production, quality, prices, costs, loss of markets, the environment, income, wealth, and health. While some have proposed modest expansions in what risks crop insurance can cover, crop insurance today is focused on protecting against the impacts of natural disasters on production and production quality and on output price declines.

Price risk covered. The major field crops rely heavily on individual revenue insurance. The insurance price for most of these products that is used to establish the insurance guarantee is the price of a futures contract averaged during a period just before planting. The settlement price is the price of the same futures contract averaged during a harvest period. Thus, the price protection provided is for a drop in a futures price between planting and harvesting. Most crop insurance products do not provide protection for a price drop from an average of historical prices or from a fixed benchmark price (exceptions are AGR, AGR-Lite, and Actual Revenue History plans of insurance). *Crop insurance provides protection for the risk of a price decline within a crop year, not across crop years. If markets are in surplus and futures prices are low, the protection afforded by crop insurance will be low. The market is signaling supply contraction.*

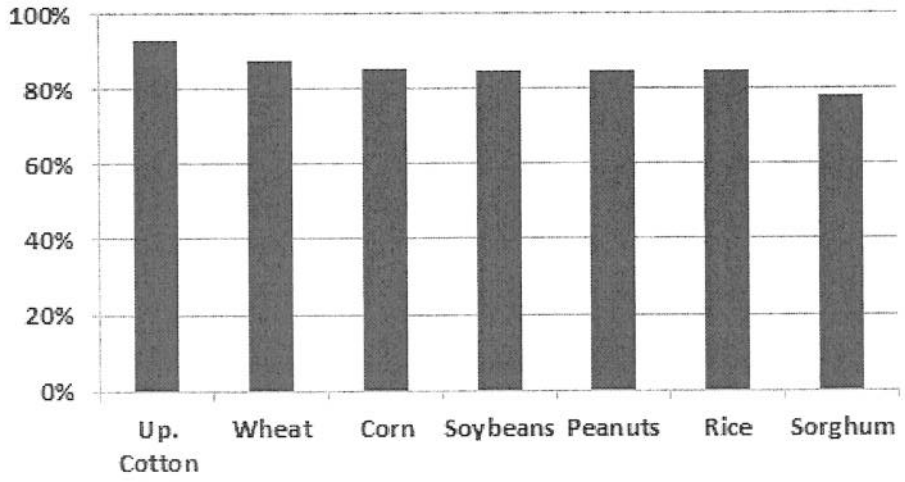
To offset the income prospect of low prices, some have proposed using historical average prices or fixed prices to set the guarantee. The objective of the crop insurance program is to protect against the decline in the current value of an asset, so using a price to set the guarantee that exceeds the expected market price creates problems. If the expected harvest price is below the guaranteed price, an expected loss would be "built in" and adverse selection would result, unless the premium rate reflects the difference between the expected price and the average or fixed price. Building in an expected loss also creates the issue of who is responsible for covering that loss, if realized. *Historical average prices and fixed prices are more appropriately used in farm revenue programs that are directed at supporting income above market-based levels, rather than in crop insurance, which is directed at protecting assets at current market values.*

Production risk covered. An issue is whether something should be done for the uninsurable portion of production, or the deductible component of crop insurance. The deductible exists to prevent moral hazard—actions by the insured that increase the chance of loss. The deductible also serves to address the uncertainty about the relationship between underwriting standards and production outcomes, that is, the inability to accurately estimate appropriate premiums. Most major crops in most areas have an 85 percent maximum coverage level for individual policies and a 90 percent maximum coverage level for county-based policies.

Some have suggested that crop insurance deductibles, combined with the 10-year Actual Production History yield, which lags trend yields, do not provide high enough coverage. The argument is that small losses, so-called "shallow losses," year after year may not trigger a crop insurance indemnity but may drive a farm to financial ruin. There is merit in this argument. However, the key question is: how much risk should producers bear and how much risk should taxpayers bear? Deductibles are common in most forms of insurance, such as health or automobile and are appropriate in crop insurance. *As long as the price guarantee is an expected market price, if insurance were to provide too high a level of coverage, the main risk is moral hazard. But if the price guarantee were to exceed the expected market price and coverage level is too high, such a program risks interfering with market price signals and distorting production.*

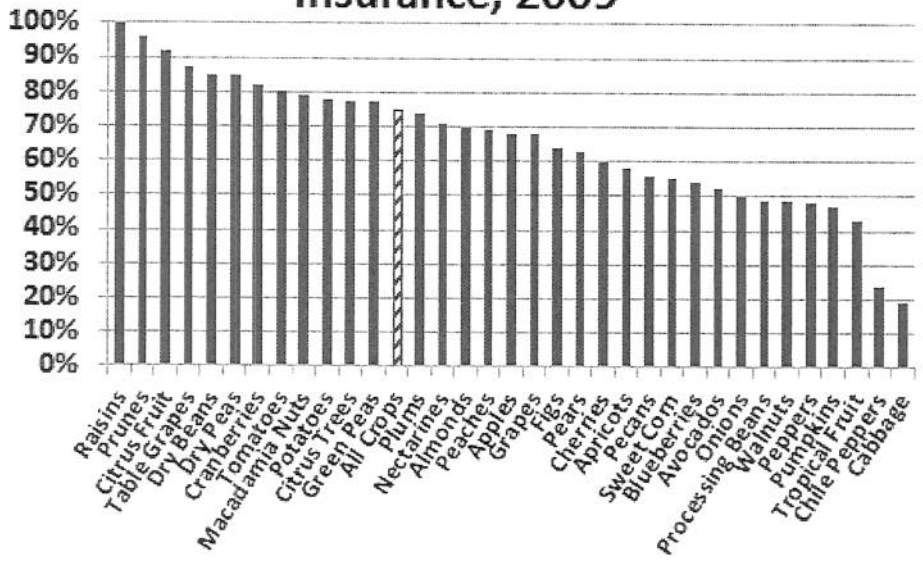
Crops/regions covered and coverage levels. Some have argued crop insurance does not work well for some crops and some regions, compared with others. There is truth in the claim, but the data suggest that crop insurance is working very well for much of the country and can be improved further. Figure 1 shows that of the 315 million acres planted to principal crops in 2011, 84 percent, or over 265 million acres, were in the crop insurance program. Participation by crop does vary, but it is high for the major program crops and for many specialty crops. Since many crops are regional, data on participation by crop is suggestive of participation by crop and region. Figure 3 shows the percentage of planted acres participating in the crop insurance program in 2011 by major crop, which ranges from 78 percent for sorghum to 93 percent for cotton. Figure 4 shows the participation for insurable specialty crops during 2009, which ranges from less than 20 percent for cabbage to more than 80 percent for a number of crops. There have been substantial efforts made by the Risk Management Agency (RMA) and private interests to increase the number of crop insurance products and features to expand coverage. Since 2000, we count over 50 new product introductions. In 2012, there will be new products for popcorn, strawberries, tangerine trees, Texas citrus trees, camelina, pistachios, and olives.

Fig. 3. Share of Major Program Crop Acres in Crop Insurance, 2011



Source: USDA/RMA Summary of Business

Fig. 4. Share of Specialty Crop Acres in Crop Insurance, 2009



Source: RMA Specialty Crops Report, 2010

While many crops show participating acres are at high levels, an issue is whether the acres are protected at low or high coverage levels. Table 1 shows the share of acres and total premium at 75 percent or greater coverage levels for major program crops. The acreage share ranges from 16 percent for rice to 63 percent for corn. The premium share ranges from 23 percent for upland cotton to 72 percent for corn. There are many reasons for such differences. They range from the risks producers face or perceive they face; to the alternatives available to manage risks, such as irrigation, variety selection, and other practices; to the premium rates charged. In many cases, a producer opting for lower coverage is making a rational choice given costs and alternatives, and that choice does not represent a failure of the crop insurance program.

The issue of providing some protection for uninsured production is partly an issue of farmers choosing less than full insurance and partly an issue of coverage limited by the deductible and the APH yield. One observation is that over time producers are choosing to increase their coverage levels. In 1996, only 12 percent of the premium sold for buy-up coverage for all commodities was for policies with 75 percent or higher coverage. By 2002, that figure was 39 percent and by 2011, it reached 57 percent. Higher premium subsidies and, recently, the use of Enterprise Units have been important factors in the coverage increases. For 2012, RMA has announced premium reductions for corn and soybeans and a pilot program that uses trend yields to adjust up a producer's APH. Both of these developments are likely to increase average coverage levels again in 2012.

Table 1. Share of Insured Acres and Premium at 75% or Higher Coverage Levels, 2011

Coverage	Wheat	Rice	Corn	Sorghum	Soybeans	Peanuts	Cotton
Percent of Insured Acres							
75-90%	29	16	63	18	60	18	17
Percent of Total Premium							
75-90%	36	38	72	25	70	30	23

Program costs. As crop insurance has grown in participation and coverage, the Federal cost of the program has increased. A major factor has been the increase in commodity prices, which raises the insured value of crops and increases the value of any quantity of production lost to natural disasters. There are several factors to consider when looking at crop insurance program costs. As noted earlier, the combined spending on crop insurance and farm programs has been trending down as crop insurance has taken on a greater role in protecting farm revenue, with farm programs taking a lesser role. The new Farm Bill will lower agricultural spending further and should do so by prioritizing programs. The crop insurance program was cut in the 2008 Farm Bill and in the 2011 Standard Reinsurance Agreement, which now means administrative and operating payments to companies are capped, agent commissions are capped, and company returns have been reduced. Premium rate reductions in 2012 should further reduce spending and company rates of return. Company rates of return in 2011 and expected for 2012 are well below those of recent years. Finally, Congressional baseline projections of crop insurance program costs have consistently been overestimated in recent years. Projections are highly uncertain and depend on market price projections. If prices turn out lower and yields are good, program costs could be substantially lower.

Recently, there has been some discussion of premium subsidy limits applied to producers. Such limits make some sense for payments that are made to enhance income, such as Direct Payments. Payment limits may make less sense for a program where producers share the cost and where receipt of the program benefits—the indemnities—require producers to incur losses. Crop insurance is structured to treat farmers equally regardless of size and value of commodities produced. Weather disasters do not happen in just some counties or on just small farms or large farms. They happen everywhere and anywhere. A consideration is that subsidy limits would affect farms differently, depending on the number of operators, use of share versus cash rent, value of crops produced, and risk of crops produced. With subsidy limits, large, lower risk farmers are likely to be those who choose not to participate in crop insurance. The result would be that the remaining pool of insured farmers would be higher risk, leading to higher loss ratios over time and increased premium rates for those that remain in the program.

Meeting the Challenge of a Farm Bill Safety Net

I will end my comments with a few thoughts on the design of the farm safety net. The prospect of eliminating the Direct Payment program frees up sufficient funding to meaningfully contribute to deficit reduction. If other programs are cut as well, there may be ample funding for new or expanded farm programs that could complement crop insurance. It is important to understand what would be the objectives of these new programs. Several observations about crop insurance and possible new farm programs include:

- **Crop Insurance should be the core risk management tool.** My statement today has identified many reasons why crop insurance is attractive, has grown, and is the prime candidate to be the central part of the farm safety net. Today's crop insurance program has fulfilled long-term Congressional goals for a program that has high participation, provides high coverage levels, reduces *ad hoc* assistance, functions efficiently and that farmers share in the cost. Design of amended or new farm safety net programs should

start with the current crop insurance program as the basis and include making crop insurance even more responsive to producers' needs.

- **Private sector delivery should be maintained.** The benefits of private competition and efficiency have been proven in the delivery of crop insurance through the history of today's public/private partnership. Risks borne by crop insurance companies, incentivized sales and service, and compliance programs and penalties have resulted in high levels of service to producers and very low incidences of waste, fraud and abuse.
- **Government farm programs should aim to augment crop insurance not substitute for it.** Farm programs are free and providing a free good or service has the potential to crowd out one that has a cost. In the same way that *ad hoc* disaster programs crowded out crop insurance, a free farm program that replicates some or all of what crop insurance does is likely to displace crop insurance. Any supplemental program should focus on risks that crop insurance does not cover, such as multiyear depressed prices or uninsurable (as distinguished from uninsured) production. Supplemental programs that are based on area yields may reduce the interaction effect with individual crop insurance plans but may significantly crowd out county-based crop insurance plans, depending on how the supplemental plan is structured. The narrower the share of expected revenue that a supplemental program covers, the less would be the interaction effect with crop insurance. Supplemental programs that use payment reduction factors applied to payment acres may reduce the interaction effect with crop insurance. Ensuring that crop insurance indemnities are not part of the payment calculation for any supplemental revenue program would also reduce the interaction effect on crop insurance.
- **The portfolio of crop insurance products should be improved.** A policy goal should be to make crop insurance as widely and equitably available as possible for most commodities. To the extent possible and practical, the portfolio of insurance plans should be improved for small producers, socially disadvantaged producers, specialty crops, and other crops that may not be covered or have atypical or specific risks or lack transparent pricing.

Mr. Chairman, that completes my statement. Thank you for the invitation and I am pleased to respond to any questions.

BIOGRAPHY OF

KEITH COLLINS

Keith Collins currently serves as economic advisor to the President and Directors of National Crop Insurance Services, a non-profit crop insurance industry trade association whose activities involve collection and management of information, analysis and reporting of data, research, and education. He retired from the U.S. Department of Agriculture after serving initially as Acting Assistant Secretary for Economics and then as Chief Economist during 1993 to early 2008. As Chief Economist, Keith advised the Secretary of Agriculture on economic impacts of programs, regulations, and proposed legislation. In addition, he was responsible for USDA's World Agricultural Outlook Board, Office of Energy Policy and New Uses, Global Change Program Office, and Office of Risk Assessment and Cost-Benefit Analysis. Keith also served as Chairman of the Board of Directors of the Federal Crop Insurance Corporation from 2001-2007 and Chairman and Vice Chairman of the General Administrative Board of the USDA Graduate School. He also chaired the national commission on payment limits, created by the 2002 Farm Bill, and he coordinated analysis for the administration's 2008 Farm Bill proposals. He has been elected a fellow of the American Agricultural Economics Association. Other recognition includes receiving the Presidential Rank Award for Meritorious or Distinguished Executive five times, the Distinguished Service Award from the American Farm Bureau Federation, the Distinguished Service Award from the American Agricultural Editors Association, the Career Achievement Award in Public Policy from the Farm Foundation, and an Outstanding Alumnus Award from N.C. State University. He holds degrees from Villanova University, University of Connecticut, and a Ph.D. in economics and statistics from North Carolina State University.

Committee on Agriculture
U.S. House of Representatives
Required Witness Disclosure Form

House Rules* require nongovernmental witnesses to disclose the amount and source of Federal grants received since October 1, 2009.

Name: Dr. Keith Collins

Organization you represent (if any): National Crop Insurance Services

1. Please list any federal grants or contracts (including subgrants and subcontracts) you have received since October 1, 2009, as well as the source and the amount of each grant or contract. House Rules do NOT require disclosure of federal payments to individuals, such as Social Security or Medicare benefits, farm program payments, or assistance to agricultural producers:

Source: N/A Amount: _____

Source: _____ Amount: _____

2. If you are appearing on behalf of an organization, please list any federal grants or contracts (including subgrants and subcontracts) the organization has received since October 1, 2009, as well as the source and the amount of each grant or contract:

Source: See Attached Amount: _____

Source: _____ Amount: _____

Please check here if this form is NOT applicable to you: _____

Signature: Keith J. Collins May 11, 2012

* Rule XI, clause 2(g)(5) of the U.S. House of Representatives provides: *Each committee shall, to the greatest extent practicable, require witnesses who appear before it to submit in advance written statements of proposed testimony and to limit their initial presentations to the committee to brief summaries thereof. In the case of a witness appearing in a nongovernmental capacity, a written statement of proposed testimony shall include a curriculum vitae and a disclosure of the amount and source (by agency and program) of each Federal grant (or subgrant thereof) or contract (or subcontract thereof) received during the current fiscal year or either of the two previous fiscal years by the witness or by any entity represented by the witness.*

PLEASE ATTACH DISCLOSURE FORM TO EACH COPY OF TESTIMONY.

National Crop Insurance Services
8900 Indian Creek Parkway, Suite 600
Overland Park, KS 66210

KC May 11, 2012

Expert Review Blanket Purchase Agreement Contracts Since October 1, 2009

CI-Actual Production History Pistachio Pilot Program 05-19-11 01 (June 2011)	$32,577.00
Total Expert Review Blanket Purchase Agreement Contracts	**$32,577.00**

Gov Works Contracts Since October 1, 2009

Evaluation of Cotton Loss Adjustment Standards Handbook and its use of AUP Cotton Stripper and Picker Factors - ID/IQ (January 1, 2011 – May 31, 2011)	$41,395.68
Total Gov Works Contracts	**$41,395.68**

Evaluation of Cotton Loss Adjustment Standards Handbook and its Use of AUP Cotton Stripper and Picker Factors, Task Order 2 and Optional Task Order 1 (Field Tests) (January, 2012 – Present)

Contract Awarded – Not Completed

Year One (2012)	$159,638.26
Year Two (2013)	$162,525.55
Year Three (2014)	$179,166.86
Total Gov Works Contracts to be Completed	**$501,330.67**

Risk Management and Community Outreach Program Subaward Agreements Since October 1, 2009

Subcontract, Delaware State University	$10,000.00
Cooperative Agreement, RMA	$100,000.00
Total Risk Management and Community Outreach Program Subaward	**$110,000.00**

Crop Insurance Education in Targeted States Cooperative Agreements Since October 1, 2009

Subcontract, University of Rhode Island	$37,500.00
Subcontract, University of Rhode Island	$37,500.00
Subcontract, University of Rhode Island	$37,500.00
Total Crop Insurance Education in Targeted States Cooperative Agreements	**$112,500.00**